Supreme Court, U.S.
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No. 96-842

In the Supreme Court of the United States

OCTOBER TERM, 1996

UNITED STATES OF AMERICA, PETITIONER

v.

JAMES HERMAN O'HAGAN

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. Respondent contends (Br. in Opp. 13-15) that the evidence at trial was insufficient to show that he traded in Pillsbury securities on misappropriated, nonpublic material information about Grand Metropolitan's plan to acquire Pillsbury stock. He argues that he did not learn, from his conversation with Thomas Tinkham, the identity of the client that had retained Dorsey & Whitney in connection with the acquisition of Pillsbury; that Grand Met's designs on Pillsbury were known to the public by that time; that Grand Met had not decided to take over Pillsbury by the time of his conversation with Tinkham; and that he had begun acquiring Pillsbury securities even before his conversation with Tinkham.

Respondent's factual assertions are either incorrect or irrelevant.[1] More importantly, however, they provide no basis for the Court to deny review of the legal issues presented by the petition. The court of appeals reversed respondent's convictions, not because of insufficient evidence, but because it held that the theories of criminal liability under SEC Rule 10b-5, 17 C.F.R. 240.10b-5, and SEC Rule 14e-3(a), 17 C.F.R. 240.14e-3(a), that formed the basis of his prosecution are not valid. See Pet. App. 1a-2a. Those are the issues raised by our petition.

Furthermore, the factual issues raised by respondent were rejected by the jury. The trial court instructed the jury that, among the essential elements of a Rule 10b-5 violation in this case was that "the defendant gained access to, and then misappropriated material, nonpublic information, which was to be used

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[1] Respondent's contention that Grand Met's plans were not secret is belied by the security precautions taken by his law firm (Pet. 4). His claim that Grand Met did not have a plan to take over Pillsbury is undercut by the retention of Dorsey & Whitney to help implement that plan. Whether or not Grand Met's Board of Directors had formally implemented a course of action to acquire Pillsbury by hostile takeover (see Br. in Opp. 2), Grand Met had taken substantial steps to acquire Pillsbury by the time of respondent's conversation with Tinkham. Whether or not respondent's trades before his conversation with Tinkham were lawful, his acquisitions of Pillsbury securities after that conversation were trades on the material, nonpublic information that he obtained in that conversation. Finally, respondent's purported ignorance of the client's name does not negate his fiduciary duty to that client. The material, nonpublic information (which respondent unquestionably possessed) was that a tender offer for Pillsbury was being planned by a client of his law firm. Respondent owed a duty of trust and confidence to that client, whatever its identity.

only for Grand Met's purposes through a relationship of trust and confidence." 2/8/94 Tr. 27-28; see *id.* at 28-29 (instructing that, to convict respondent, jury must find that respondent owed a duty of trust and confidence to either Grand Met or Dorsey & Whitney, or both). The court further instructed that the government was required to prove that the pertinent information was both material and nonpublic. *Id.* at 31-32. As to the Rule 14e-3 charge, the court noted that "it is claimed that [respondent] purchased these securities after Grand Met had taken substantial steps toward the making of a tender offer." *Id.* at 35-36.[2] The court instructed that, under Rule 14e-3, the government was required to prove, among other things, that "Grand Met ha[d] taken a substantial step or steps to commence a tender offer for the stock of Pillsbury; * * * that [respondent] was in possession of material information relating to this tender offer, and [respondent] knew the information was material; * * * [and that] the information was nonpublic and

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[2] Respondent contends (Br. in Opp. 29) that no "tender offer" existed until the Board of Directors of Grand Met finally authorized and announced one, and therefore his trades, which took place before the announcement, could not have violated Section 14(e) or Rule 14e-3. Section 14(e), however, prohibits fraud, and authorizes the SEC to adopt rules to define and prevent fraud, "in connection with" any tender offer. See 15 U.S.C. 78n(e). The SEC, in Rule 14e-3, has construed the "in connection with" language to encompass situations where a bidder has taken "a substantial step or steps to commence * * * a tender offer." That reading is a reasonable construction of the statute entitled to deference. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). In this case, Grand Met had taken "a substantial step or steps," by retaining counsel and otherwise preparing for its eventual tender offer. See Pet. App. 2a.

[respondent] knew the information was nonpublic." *Id.* at 38.

The jury found respondent guilty under those instructions, and therefore necessarily concluded that the government had established, beyond a reasonable doubt, that respondent traded on material, nonpublic information about the takeover of Pillsbury. The trial court also denied respondent's motion for acquittal. 10/27/94 Tr. 24-25. Accordingly, respondent's claim of insufficient evidence provides no basis for denying the petition for a writ of certiorari.

2. Respondent argues (Br. in Opp. 15-16, 18) that there is no true circuit conflict on the validity of the misappropriation theory of liability under Rule 10b-5 or the validity of Rule 14e-3(a) because no court of appeals has expressly considered the validity of the misappropriation theory or Rule 14e-3 in light of this Court's decision in *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). In fact, since *Central Bank*, both the Second and Seventh Circuits have reaffirmed their previous approvals of the misappropriation theory. See *United States* v. *Mylett*, 97 F.3d 663, 666-667 (2d Cir. 1996) (upholding Rule 10b-5 liability based on information about planned takeover misappropriated from acquiring company); *SEC* v. *Maio*, 51 F.3d 623, 631, 633-634 & n.12 (7th Cir. 1995) (same).[3] And the Seventh Circuit in *Maio* also expressly upheld the validity of Rule 14e-3. *Id.* at 634-635. There exists, therefore, a live circuit conflict on both issues warranting this Court's review.

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[3] The Ninth Circuit has not addressed the misappropriation issue since *Central Bank*. The issue is presented in *SEC* v. *Goldinger*, No. 95-56092 (9th Cir.) (argued Nov. 6, 1996).

Moreover, *Central Bank* did not announce any principles of analysis that would warrant reconsideration of the validity of the misappropriation theory or Rule 14e-3. *Central Bank* did not involve the validity of any theory of primary liability for securities fraud; the question in that case was whether there is a private cause of action against an alleged aider and abettor of a violation of Section 10(b) and Rule 10b-5. 511 U.S. at 167. That issue has no relevance here, for respondent was convicted as a primary violator of the securities laws. And although respondent contends that *Central Bank* changed the principles of statutory construction applicable to the securities laws by emphasizing that "the text of the statute controls" (Br. in Opp. 16), that principle is well established in this Court's decisions interpreting Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b). See, *e.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976). In fact, the *Central Bank* decision itself applied "settled methodology," as described "in earlier cases." 511 U.S. at 177.

3. Respondent also argues (Br. in Opp. 21-22) that, in the legislative history of the Insider Trading and Securities Fraud Enforcement Act of 1988, Congress "expressed doubts" as to the validity of the misappropriation theory. Respondent discerns such "doubts" in a statement in a committee report to the effect that the status of the misappropriation theory was then "unresolved nationally." H.R. Rep. No. 910, 100th Cong., 2d Sess. 10 (1988). That statement reflected the fact that, at the time it was made, no court of appeals other than the Second Circuit had expressly adopted (or in fact had considered) the theory. Far from expressing doubts about the validity of the misappropriation theory, however, the House Energy

and Commerce Committee expressed its approval of the theory in the very next sentence of the report when it stated: "In the view of the Committee, however, this type of security fraud should be encompassed within Section 10(b) and Rule 10b-5." *Ibid.*; see also *id.* at 26-27 (the misappropriation theory "fulfills appropriate regulatory objectives in determining when communicating or trading while in possession of material nonpublic information is unlawful"). In fact, as early as 1984, the House Committee Report accompanying the Insider Trading Sanctions Act of 1984 cited with approval the Second Circuit's misappropriation decision in *United States* v. *Newman*, 664 F.2d 12 (1981), cert. denied, 464 U.S. 863 (1983). See H.R. Rep. No. 355, 98th Cong., 1st Sess. 5 n.8. (1983).

4. Finally, respondent argues that the court of appeals' reversal of his mail fraud convictions does not conflict with this Court's decision in *Carpenter* v. *United States*, 484 U.S. 19 (1987), because the court of appeals expressly recognized that, under *Carpenter*, "where both mail fraud and securities fraud counts are brought, they are [not] necessarily interdependent." Br. in Opp. 30. That argument is without merit.

While the court of appeals purported to follow this Court's holding in *Carpenter*, its analysis sharply departed from that decision. The court of appeals stated that, because respondent's "conduct did not constitute securities fraud, * * * there was no fraud upon which to base the mail fraud charges." Pet. App. 37a. Under that analysis, a court could never uphold a mail fraud count if the underlying conduct also formed the basis of a securities fraud count that was dismissed by the court. *Carpenter* makes clear, however, that mail fraud charges are independent of securities fraud charges even when both rest on the

same facts. The Court in *Carpenter* unanimously affirmed the petitioner's mail and wire fraud convictions, even though the Court was evenly divided with respect to the securities fraud counts. Accordingly, contrary to the court of appeals' holding, a defendant may be punished for mail fraud even if the indictment "premise[s] the fraud for the mail fraud charges on the acts allegedly constituting the securities fraud." Pet. App. 37a. See also *United States* v. *ReBrook*, 58 F.3d 961, 967 (4th Cir.), cert. denied, 116 S. Ct. 431 (1995). Accordingly, the Court should grant review of the court of appeals' decision on the mail fraud counts in this case to reaffirm *Carpenter*'s holding that acts may constitute mail fraud, whether or not those same acts violate other prohibitions against fraud as charged in the indictment.

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For the forgoing reasons, and also for the reasons set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General

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